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China: The Next Oil Giant

TIME BOMB IN EAST ASIA

by Selig S. Harrison

THE POLITICS OF CHINA'S OIL WEAPON

by Choon-ho Park and Jerome Alan Cohen

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REPRINT

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Harrison

PRC Dom energy needs Prog Res by Trento
929 mil tons by 1985 Utsuno
807 " " 1985 Kumbaro

Trend toward oil away from coal
good econ basis for this shift
pol factors too
1. road transport as key element in integ. process

Jap ext. trade up 48% by 1985
= 447 mil tons oil for 8.8% growth
390

Diff for PRC to achieve 5% oil growth rate
need 250-300 mil tons in Po Hai by mid.
to sustain above figures. Requires very
off. program.

Sees pop as you go process

China: The Next Oil Giant

In our preoccupation with the price of oil and the confrontation with established producers, little attention has been paid to the profound political consequences resulting from new oil discoveries and exploration in various parts of the world, especially in offshore areas where undersea boundaries are in dispute.

The impact of China's emergence as an oil power with offshore ambitions is being felt not only throughout Asia but also in Washington, as Selig S. Harrison reports in a revealing article presenting some of the preliminary findings of a year-long investigation conducted on behalf of the Carnegie Endowment for International Peace. Harrison interviewed more than 200 oilmen, officials, and others throughout Asia, the United States, and Europe. A broader report will be published later in book form.

In a companion article, Choon-ho Park and Jerome Alan Cohen of Harvard's East Asian Legal Studies Program probe the background of China's unexpected rise as a major oil producer, the domestic factors likely to affect its future production levels, and the potential implications of Peking's ability to back up its diplomacy with the oil export weapon.—The Editors.

TIME BOMB IN EAST ASIA

by Selig S. Harrison

The rapid emergence of China as a major oil producer is fundamentally transforming the geopolitical map of Asia. Already, by drawing only on its onshore reserves and

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those of the Po Hai Gulf, Peking appears likely to reach the current production level of Saudi Arabia by 1988 or soon thereafter.[1] By exploiting its rich continental shelf reserves as well, Peking could rival the present production leaders within two decades. Chinese preparations for offshore oil development have become increasingly intense, giving new sensitivity to long-simmering disputes with Taiwan and South Korea over parts of the shelf widely believed to contain the most promising unexplored oil and gas deposits in the world. At the same time, China is utilizing oil exports to buy off other claimants to disputed offshore deposits, notably Japan, North Korea, and North Vietnam.

For the United States, the rise of China as an oil giant is not likely to mean a new source of crude oil in significant quantities or a sudden opportunity to "break OPEC." The net effect of expanded Chinese oil exports would be to reduce global dependence on the Middle East and the Persian Gulf; but the principal direct beneficiaries of a Chinese export thrust are likely to be Japan and other politically favored customers, especially in Asia. China has persistently rebuffed efforts by American oil companies to line up Chinese crude in return for technical help in expediting undersea development. Instead, Peking is actively seeking to acquire its own offshore equipment and know-how, and it is the prospect of unilateral Chinese activity on the continental shelf that makes the Peking drive for oil power a matter of immediate concern to U.S. policy-makers.

As we shall see, the United States finds itself squarely in the middle of the explo-

[1] *Saudi Arabia produced 412 million tons in 1974. For an authoritative Japanese projection of 440 million tons by 1985, see* JETRO China Newsletter, *published by the Japan External Trade Organization, Tokyo, April 1975, especially "Model II," pp. 16-17. This incorporates the findings of a Nomura Research Institute study. By contrast, a Taiwan analyst argues that even under optimal assumptions, Peking could not reach 400 million tons before 1990-1993* (Issues and Answers, *Taipei, March 1975, p. 76). My own analysis leans to the Japanese projection but allows for probable logistic delays.*

develop. In this respect, the normalization of Sino-American relations may enhance the prospects of American firms to some extent.

In the near future, Washington may have to consider more carefully than it has whether the United States should become involved, through governmental or private agencies, as a potentially stabilizing investor in the sensitive oil projects in which the Soviet Union has thus far unsuccessfully sought to enlist Japan. American involvement might render Japanese participation less objectionable to the PRC as well as shore up Japan's confidence in other aspects of the arrangements.

A decision on this question will affect another, longer-range problem that has begun to trouble thoughtful minds as stories circulate that PRC officials talk of exporting 50 to 100 million tons of oil to Japan by 1980. Will China some day be able to export so much oil and other resources to Japan as to gain undue influence over it? Given Japan's policy of diversifying sources of supply, is it likely that Japan, having learned the hard way, would ever allow itself again to be placed in that position? If so, would China seek to use its oil leverage to separate Japan from the United States? Since the fall of the Sato government in 1972, the PRC has made a remarkable switch in policy, striving to enlist the United States and Japan in an East Asian *entente cordiale* against the Soviet Union. In his avuncular way, Chou En-lai has been admonishing Henry Kissinger to treat the Japanese with greater consideration, and he has been assuring the Japanese that the security treaty with the United States is quite acceptable. Will another swing of the foreign policy pendulum lead China to revert to its pre-1972 antipathy to the U.S.-Japan alliance, this time with the means to make its will felt? We should welcome China's oil but recognize that, for us, enormous quantities of it may be a mixed blessing.

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with OPEC and the Arab oil-exporting states. It already means an increasing potential market for the sale of American oil-development machinery and technology, as has been demonstrated by the expanding number of transactions in this area since 1973. And it guarantees China the foreign exchange to purchase a broad range of other American products.

The prospect of China's oil industry as an investment market for American or other foreign capital, however, remains much less promising, because of the PRC's adherence to the basic principle of self-reliance. Western and Japanese multinational corporations have been earnestly exploring a variety of possibilities for participating in China's oil future, whether by joint ventures or other devices. While repeating in categorical terms its determination to go it alone, the PRC has been exposed to a host of blandishments and temptations. But China has said so much against multinational corporations and joint ventures that it can hardly afford to give in before the watchful eyes of the Third World.

Yet, China does not identify self-reliance with seclusion, nor does it rule out various arrangements based upon "equality and mutual benefit." Joint ventures may well be out, but production-sharing, service contracts, and other techniques that do not involve foreign equity interests may prove to be acceptable. American oil companies are already marketing Chinese oil in Hong Kong and bunkering Chinese ships in many countries, and current discussions cover a range of other cooperative possibilities including marketing Chinese oil in this country and assisting with refinery expansion in China. Thus it remains to be seen how flexibly the PRC will interpret self-reliance in this age of interdependence. The degree of flexibility may ultimately reflect, internally, the pace at which the PRC chooses to modernize its agriculture and industry and, externally, the direction in which PRC relations with the United States, the Soviet Union, and Japan

sive continental shelf controversy. Nine American oil companies hold offshore concessions granted by Taipei and Seoul in waters claimed by Peking, and many of these companies would rather get while the getting is good, under present arrangements, than wait for a hypothetical future change in the Chinese attitude. Washington, for its part, is more than ordinarily anxious to avoid provoking Peking in advance of the Presidential visit to China this fall. In two cases this year to be discussed later in this article, the White House and the State Department were able to dissuade leading oil companies from drilling in contested waters only after varying degrees of behind-the-scenes pressure and a helpful, eleventh-hour assist, in each case, from lady luck.

For the past 11 years, Chinese crude production has increased at an average annual rate of 24.6 per cent, jumping from 6.4 million tons in 1963 to 20 million tons in 1970 and nearly 70 million tons in 1974, the latter figure including exports of 5 million tons to Japan. How much longer this rate can continue, however, remains a subject of debate. The attempt to project future Chinese production and export levels is a risky game fraught with more than the customary quota of the booby traps that bedevil petroleum futurology. Japanese spokesmen inflate their projections to improve their bargaining posture with OPEC and the Western majors; the Chinese encourage Japanese optimism as part of their anti-Soviet strategy; and the Western oil companies, given their interests elsewhere, tend to minimize Chinese prospects and technical capabilities. In order to evaluate such projections, one should take into account a wide range of economic and political variables,[2] among them China's industrialization plans, domestic energy needs, alternative energy sources, and the role of differing export strategies in various economic policy scenarios. At the same time, one should consider these

[2] *See the accompanying article by Choon-ho Park and Jerome Alan Cohen.*

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factors against the larger regional background of the continental shelf issue. Our attention here will be focused primarily on the struggle over offshore resources, not only as a politically dangerous dilemma for the United States but as a pivotal variable molding and shaping many of the other factors that will govern Chinese oil prospects.

Assessing the Reserves

Depending on the outcome of the offshore boundary scramble, the addition of an offshore dimension could at least double the Chinese oil potential even by relatively conservative estimates. Thus, geologist A. A. Meyerhoff, who estimates *recoverable* onshore reserves to be "not less" than 20 billion barrels and says that they "may" reach 40 billion, has recently made a 30 billion estimate for recoverable offshore reserves.[3]

These are cautiously low figures in comparison with many other Japanese and American estimates, especially with respect to offshore reserves, though they are broadly similar to offshore estimates by Soviet geologists and by a Norwegian oceanographer, Jan-Olaf Willums, who has utilized a different method of calculation. Meyerhoff divides his total into 12.84 billion barrels for the East China Sea; 8.03 billion for the South China Sea, inclusive of the Taiwan Strait; and 5.6 billion each for the Yellow Sea and the Po Hai Gulf. By contrast, many Japanese estimates go as high as 10 billion for the Po Hai Gulf alone. In the case of the Yellow Sea, a U.S. Geological Survey China specialist, Maurice Terman, has recently completed unpublished tectonic studies that point to substantially higher estimates.

[3] *Recoverable reserves represent a percentage of potential reserves. This percentage, in turn, is fixed in accordance with varying geological assessments of global oil production experience. Meyerhoff uses 22 per cent, but some analysts regard this as somewhat low and many also believe, with respect to China, that his estimates of potential reserves are themselves conspicuously low. His published estimates* (World Petroleum Report '75, *p. 21) do not differentiate by area but were elaborated in discussions with the present author.*

February 1975, China undercut Indonesia by charging Japan $12.10 for a barrel of crude, 50 cents lower than the Indonesian price, though still higher than the average OPEC price of $10.46. A real competition will arise should China decide to supply a major portion of Japan's demand for oil, because this will arouse the Persian Gulf producers upon whom Japan relies for over 75 per cent of its oil needs. The demand for Middle East oil will then diminish proportionately, as will the political burdens of the countries against which the oil weapon was originally aimed in 1973.

Thus far China has shown no interest in OPEC membership. But the question of whether to join the cartel will command increasing attention. OPEC's bylaws require a prospective member to be a substantial exporter of oil and to have the same basic interests as other members. China surely could claim to meet these stipulations, and it may look strange if the PRC should choose to remain outside of OPEC once it becomes a substantial exporter. Yet, as a major political power seeking to befriend the "have-nots" as well as the "haves" of the Third World, China will find it difficult to ignore the fact that OPEC's interests do not coincide with those of oil-importing developing countries and that resort to the "friendship price" system will not be possible, once within the cartel.

Implications for the United States

Finally, in addition to enhancing the PRC's overall political, military, and economic importance, what will China's emergence as an oil power mean for the United States? It may mean that the United States, as well as Western Europe, Australia, and previously mentioned countries will eventually be able to look to the PRC for an important share of imports. Whether this would help to bring down the price of oil and to reduce the United States' and its allies' vulnerability to political blackmail would depend in part on Peking's relations

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of indigenous means to process them. China has offered its own example as a model of how this can be done. By becoming a substantial oil exporter, the PRC will be providing further confirmation that its practice matches its theory.

This will be particularly appreciated by those oil-hungry developing nations that become the beneficiaries of Chinese exports. Indeed, in its relations with the Philippines and Thailand—two countries that were formerly hostile to the PRC—Peking has already begun to vindicate not only the virtues of self-reliance but also the reality of its other international economic slogans, such as "according to each other's needs and possibilities," "equality and mutual benefit," and especially "friendship first, trade second." In initiating modest oil exports to the Philippines and Thailand, at a time when neither had established diplomatic relations with the PRC, Peking was careful to charge these new customers a "friendship price" rather than what the market would bear. The Philippines, for example, paid only $7.50 for a barrel of Chinese crude, while Japan was paying $12.10—a vivid demonstration of Peking's continuing preference for placing economics in the service of politics. In few other ways can China so easily win the hearts of oil-importing developing countries.

Yet China's relations with oil-exporting countries will become more complex if it should begin to make an impact on the world oil market. Although the PRC has benefited greatly from the extraordinary rise in the price of oil and has endorsed both the organization of OPEC and the Arabs' use of oil as a diplomatic weapon, some problems have already surfaced.

A significant increase in oil export will create competition with other exporters, most of them developing countries that depend on oil as a principal source of revenue and whose economic interests China is pledged to support. In a way, China is already in competition with Indonesia. In

Meyerhoff excludes from his estimates potentially rich areas that are implicitly defined as part of its shelf jurisdiction by China but have not been treated as such by the United States in Law of the Sea discussions. Other areas in the South China Sea claimed by China for different reasons have also been excluded. In any case, as the North Sea experience suggests, the full dimensions of the recoverable Chinese offshore potential could prove to be much higher (or lower) than 30 billion barrels. Prior to drilling, the highest North Sea estimate was 15 billion barrels. Now company estimates range from 17 to 22 billion.

In the absence of extensive drilling under the concessions so far granted, what is known outside of China about the reserve potential of waters adjacent to the mainland has been largely based on seismic surveys and other geophysical studies conducted under the auspices of a United Nations agency, the Committee for the Coordination of Joint Prospecting for Mineral Resources in Asian Offshore Areas (CCOP); oil companies, big and small, mostly American, Japanese, and British; geophysical companies operating independently, mostly American, German, and French; and government oil enterprises in Tokyo, Seoul, Taipei, Saigon, and Hanoi. Peking, on its own, has conducted technically limited offshore surveys since 1958 and has been quietly acquiring sophisticated French, American, and Japanese equipment during the past three years for an expanded survey program that will be separately treated in a later part of this article. None of these surveys has resulted in the public disclosure of quantified projections. However, the CCOP has published a flow of generalized findings that has kept expectations high.

In 1968, a survey conducted jointly by CCOP and the U.S. Naval Oceanographic Office led to the announcement of a "high probability . . . that the continental shelf between Taiwan and Japan may be one of the most prolific oil and gas reservoirs in the

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world. It is also one of the few large continental shelves of the world that has remained untested by the drill, owing to military and political factors." [4]

The excitement generated by this report in the areas involved was a source of great irritation to many of the concerned oil companies. They had been cool to the very idea of a regional intergovernmental agency conducting public oil survey operations and were upset, in particular, to find their bargaining position complicated in then pending negotiations for offshore concessions. As a result of company pressures, K. O. Emery of the Woods Hole Oceanographic Institution, the primary author of the report, was eased out as the American representative on the CCOP staff. In their estimate of the offshore potential, however, most oil companies appear to share the optimism reflected in the Emery report. Their technical data is closely held, to be sure, and their public posture does not generally correspond to their actual plans and intentions. With this in mind, I have interviewed exploration executives and geologists in Asia-minded oil companies in the United States, Europe, and throughout Asia itself as part of a larger inquiry into the economic and political implications of the China offshore question.[5] I have made a point of talking separately with different officials working in different places within the same company and of checking them not only against one another but against what they say to the governments concerned.

In some cases, officials of leading American and Japanese companies have made partial data available on a confidential basis after satisfying themselves that my research was not a cover for someone's commercial or other intelligence operations. In others,

[4] *K. O. Emery et al., "Geological Structure and Some Water Characteristics of the East China Sea and the Yellow Sea,"* CCOP Technical Bulletin, *vol. 2, Bangkok, May 1969, p. 41.*

[5] *This investigation was conducted for the International Fact-Finding Center, a program of the Carnegie Endowment for International Peace devoted to the study of "near horizon" problem areas in world affairs.*

principles and political priorities. With shelf-boundary demarcation law still in the remaking and the East China Sea, in particular, brimming with difficult political and legal problems, Peking prefers to begin undersea oil extraction on its own in the ample and uncontested shelf immediately adjacent to its coast. Although South Korea has now ratified the 1974 agreement, Japan has thus far failed to do so, not only because of continuing political friction with Seoul and Tokyo's belated realization that it may have made a bad bargain in light of the swift international acceptance of a 200-mile economic zone, but also because it failed to foresee the degree of Peking's concern over the agreement.

Japan cannot be happy about the pressures China has successfuly brought to bear on its efforts to ease its dependence on Middle Eastern oil by seeking Soviet and Korean cooperation. What makes China's actions tolerable to Japan is the evidence of Peking's intention to supply Japan with increasingly substantial quantities of oil. If China's political pressures represent "a stick" to Japan, the prospect of major Chinese oil exports offers "a carrot." Should China fail to fulfill the expectation it has encouraged, Japan would have to re-examine its hesitancy to make other arrangements. What consolation South Korea can find is far less clear, for it does not share the prospect of receiving Chinese oil and confronts the potentially dangerous question of whether to risk proceeding unilaterally to extract oil from the continental shelf.

Relations with the developing world provide the PRC with additional incentive to export a significant amount of oil. Peking has long sought to enhance its influence with the new nations by telling them what they fervently want to believe—that they can have self-reliance and national independence on the one hand, and economic development on the other, and that natural resources, even in their crude state, can be converted into tremendous assets regardless

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miles away creates a host of problems for Japan.

In these circumstances, it is hardly surprising that Japan, in addition to purchasing more oil from Indonesia, has sought oil sources close to home: in China, in the Soviet Union, and in the seabed between Japan and Korea. China's objective has been to forestall all significant forms of Japanese cooperation with the Soviet Union, including participation in the joint projects to develop Tyumen oil and Sakhalin seabed oil with which Moscow has tempted Tokyo. Because of Japan's concern about China's objection, as well as the economic terms and national security implications of these proposals, no arrangements have been concluded, even though a variety of general agreements have been signed concerning resources other than oil. Thus, Japan is walking a tightrope between two prospective sources of oil which happen to be great powers, neighbors, and the bitterest of enemies.

China has further complicated Japan's energy position by protesting against the attempt of Japan and South Korea to agree upon a joint effort to develop the oil that presumably lies within their disputed continental shelf. As one of the three coastal countries with claims to the shelf of the enclosed sea, China regards the January 1974 Japan-South Korea agreement as outright collusion with the intent of carving up the resources for themselves alone. The parties to the agreement maintain that it relates to areas sufficiently far from China to preclude a possible Chinese claim, but the PRC has insisted that there can be no settlement of the question without its participation. At the same time, it has taken the position that it will not have any contacts whatever with the South Korean government, which it regards as the illegitimate rival of China's sensitive ally Kim Il-sung.

Unlike Japan and Korea, China is under no pressure to obtain oil from the continental shelf beyond territorial jurisdiction, especially if doing so would compromise its

where companies holding concessions had attempted to sell an interest to other companies, I have been able to see proprietary seismic data used during the negotiations.

As my knowledge has grown over the past year, more and more doors have opened, and it now appears clear that the offshore areas adjacent to China are appraised with a remarkable degree of unanimity in informed quarters. Taken collectively, they are ranked as the most promising of the unexplored areas in the world. At the same time, there is widespread feeling that the high costs of exploration and development in many of these areas, added to the political uncertainties involved, may delay the commercial exploitation of these reserves. This is especially true where structures are small and complex ("fault-blocked") and where deep or tempestuous waters complicate test-drilling operations. Where exploration does occur and gas is found in areas far from shore, the peculiarly steep costs of offshore gas exploitation could also act as a deterrent to major private investments in the near future. Many American companies complain that the current confusion in U.S. energy policy has left it unclear whether they will be helped or hindered in exploring new areas abroad. Among other things, the new tax bill enacted by Congress this year abolishes the "per country" tax credit, which had hitherto made it profitable to conduct test-drilling operations within a given national jurisdiction even when no oil was found.

To Drill or Not to Drill

Given the political constraints involved, the limited drilling that has so far occurred has been inconclusive. The most promising finds have been in the South China Sea off Vietnam, where foreign companies had invested $64 million prior to the Communist victory, and in the Taiwan Strait, where a Conoco-Amoco venture has resulted in a major gas discovery that could make Taiwan almost self-sufficient in energy within

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10 years. The gas find is 60 miles off the southwest coast of the island, but it is separated from Taiwan by an undersea canyon that would have to be circumvented in piping the gas to shore. The initial development outlays required would reach at least $650 million, and the two companies are still debating whether to go ahead if test drilling continues to prove successful. Peking has greeted past drilling off Taiwan with reminders that any oil or gas found, like the island itself, belongs to China.

Conoco, Amoco, and Gulf have all deliberately chosen concession areas relatively close to Taiwan in the belief that Peking will wink at exploration and development there pending an overall settlement of the status of the island. Their hope is that the island will remain independent and that petroleum discoveries will help to guarantee this outcome; but even if it does revert to Peking, they are gambling that an increasingly moderate China would, by that time, agree to tolerable terms in renegotiating their concessions. Gulf has accordingly drilled its second and third offshore wells northwest of Taiwan this year, including one less than 125 miles from Fuchou.

Reflecting its claim to jurisdiction over the entire mainland, Taiwan has not only granted close-in concessions but has also allocated offshore rights over a 500-mile belt, north of the Gulf concession, reaching to a point in the East China Sea opposite Shanghai to the west and the South Korean and Japanese coasts to the northwest and northeast. These are even more provocative to Peking than the close-in concessions because they could only have been granted by Taipei in the capacity of an all-Chinese rather than a strictly Taiwan regime. To complicate matters further, the same areas where Taipei has granted concessions are also claimed by Tokyo as a consequence of the Japanese claim to the Senkaku islands (Tiao Yu-tai in Chinese), a group of rocky islets at the tip of the Ryukyuan chain that lies on the continental shelf and thus gives Ja-

poses. By driving oil-importing countries, developed and developing alike, into a frenzy of "natural resources diplomacy," precisely at a time when the PRC began to have oil available for export, it created an ideal situation for resolving China's foreign exchange problem. As the price of Chinese crude soared from $3.75 a barrel to $12.85, oil was suddenly seen to be the source of the vast amount of hard currency that China needs to modernize its economy without mortgaging it to foreign lenders. For example, if the PRC did, in fact, run a balance-of-payments deficit of $1.3 billion in 1974, that deficit can now be met by the sale of only 15 million tons of crude, even though prices have subsided a bit from last year's high. Thus, China's economic incentive to expand oil exports, at least to the extent of resolving its foreign exchange problem, requires little elaboration.

Oil and Foreign Policy

Substantial oil exports would also give Peking important new political leverage. Indeed, neighboring states' hopes of receiving major oil shipments, nourished by some recent initial sales, have already boosted Peking's influence in the area. Japan furnishes the most obvious and important illustration.

China sees in Japan a vivid example of the impact of oil on the fate of a nation. In the early 1940s, poverty in oil contributed to Japan's waging a world war and losing it. During the subsequent generation, an ample supply of cheap foreign oil enabled Japan to create an economic miracle after the war's devastation. Now that cheap oil is no longer available, as a result of the OPEC cartel, the Japanese economy has suffered a heavy blow, and the Japanese government conducts its affairs with full awareness that should it offend the Middle Eastern suppliers upon whom the nation relies for most of its oil, it will be subject to economic and political retaliation. The mere fact that the Persian Gulf is over 7,000 nautical

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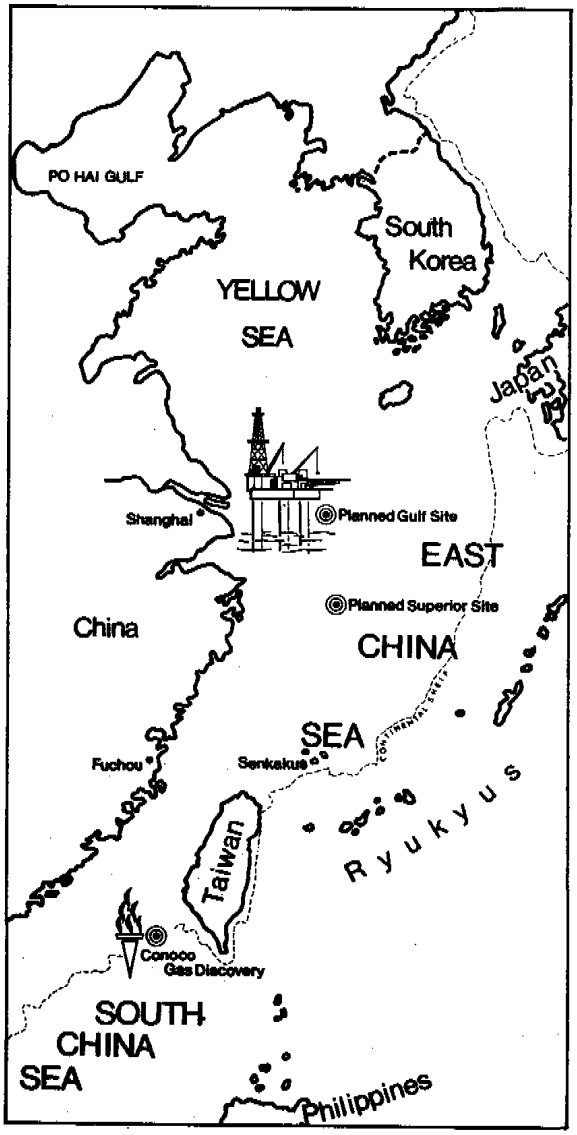
PRC leaders have been "allergic" to foreign loans. In his 1975 report to the National People's Congress, Chou En-lai claimed that, "In contrast to the economic turmoil and inflation in the capitalistic world, we have . . . contracted no external or internal debts." That statement is only accurate if based on a narrow interpretation of the word "debts," but it surely constitutes a guideline that will continue to keep China's borrowing, under whatever guise, within moderate limits. As Chai Shu-fan put it, financing industrialization and the transfer of technology by means of foreign credit, "in the manner the Soviet Union does," means, in fact, "forgoing sovereignty and independence and running the risk of introducing capitalist inflation in the costs structure of a Socialist country."

The PRC is now making an effort to reduce nontechnological imports as well as to expand exports. According to a forecast made by the National Council for U.S.-China Trade, in comparison with 1974 statistics, Chinese imports from the United States in 1975 are expected to drop by 70 per cent, from $819 million to $250 million, while exports to the United States are estimated to increase by 40 per cent, from $115 million to $170 million. Apart from possible political reasons for such a drastic reduction of imports from the United States (particularly to provide greater incentive for the "normalization" of diplomatic relations), this reflects China's efforts to adjust its overall trade balance. In January and February 1975, China canceled two contracts for one million tons of American wheat and, in March, another contract for 200,000 bales of American cotton. According to Chai Shu-fan, this was done to avoid a possible deficit: "If we export less, we import less." Yet, whatever the motivations for these cancellations, the PRC is bound to find it very painful to substantially reduce nontechnological imports.

In these circumstances, the energy crisis was too good to be true for Peking's purpan a basis for claiming rights as a shelf power. Despite scowls from Peking and Tokyo alike and cautionary words from Washington, Taipei is nevertheless pushing concession-holders to go ahead with drilling, and the prosperous government oil monopoly, the Chinese Petroleum Corporation, is rapidly developing its own offshore know-how with an eye to doing its own drilling in areas where foreign companies fail to deliver on their commitments.

All three of the most sensitive East China Sea concessions to the north of Taiwan are



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held by relatively small U.S. companies lacking the financial capability to conduct expensive deep-water drilling operations on their own. It is standard practice in oil exploration for such small promoters to locate promising possibilities, spend a few million dollars on surveys, and then try to find a better-heeled partner to put in the multimillion-dollar investment needed for sustained drilling operations. In the Taiwan case, one of these companies, Clinton International, was able to enlist the collaboration of the Superior Oil Company, among the larger and more solid independents operating abroad. Superior and its self-made president, H. B. Keck, still retain some of the gung ho spirit of their earlier, wildcatting days, and the Houston-based company had decided that it was worth taking some chances to get an inside track on one particular undersea configuration in the Clinton concession 350 miles north of Taiwan (straddling Zones 4-E and 4-F) where the geological odds for a major find were "10 to 1." Superior had lined up a rig and was scheduled to drill in April and May until the White House and the State Department intervened.

The confrontation between Superior and the U.S. government was the first and less strenuous of the two episodes this year in which Washington has blocked projected offshore drilling near China. Joseph Reid, the president of Superior's international division, had begun to have doubts when he led a delegation to Washington in early February. The group was aware that U.S. policy is to discourage drilling in disputed areas by denying the use of government satellites for navigation purposes and by forswearing any responsibility for the defense of U.S.-owned rigs or survey ships in possible clashes with Chinese naval craft. What they were not prepared for was the grim report on the current Peking attitude that they heard from ranking U.S. officials concerned with China. They were startled to learn that Peking laid serious claim to their con-

nist countries constitutes over 80 per cent of the PRC's trade. Its 1974 trade exceeded $13 billion, which more than doubled the 1970 figure. Even if we take substantial inflation into account during this period, the figures are impressive. There have also been marked increases in the number of trading partners and in the variety of commodities traded. In 1974 alone, the PRC signed no fewer than 60 agreements on economic relations with 40 countries. It held 24 commodity exhibitions abroad and many were held in China by other countries. Thus Peking is experiencing an unprecedented upsurge in trade.

Yet the very zest with which the PRC has recently expanded trade has begun to cause difficulty. In recent years, China has imported plants, equipment, and technology in massive quantities from the West and Japan. Although the commodity composition of Chinese foreign trade shows that over 70 per cent of exports may be classified as agriculture-related, more than half of its imports are technological, and there are indications that Peking would like to expand imports of this nature. This raises the problem of possible trade deficits. Although Vice Minister of Foreign Trade Chai Shu-fan recently conceded that inflation and the world economic crisis have affected China's trade balance by preventing many countries from buying Chinese goods, he denied that this had caused a trade deficit. Yet it appears that in 1974, for the first time in many years, the PRC did actually incur a substantial deficit—estimates by foreign observers vary from $200 million to $1.3 billion (including installment payments reaching maturity in 1974). Because its foreign exchange reserves are insufficient to meet recurring deficits of this magnitude, Peking, if it is determined to carry on with its program for importing technology, will have to either borrow funds, reduce other imports, or earn significantly more from its exports.

Mindful of the extent to which foreign debt meant foreign control of the old China,

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We should note that China continues to import oil occasionally, even while increasing its exports. The latest instance was a shipment of 60,000 tons, brought from Kuwait by a Norwegian-built Chinese tanker, the *Taihu*, in August 1974. A larger amount, 400,000 tons, was also reportedly obtained from the Middle East in 1970. Some observers cite such examples to support their belief that part of the oil China exports is of foreign origin or to argue that China's stated self-sufficiency in oil is questionable. But China's import of oil during the past decade has been so sporadic and the quantity involved on each occasion so small, that it could have done little to fill external or internal demand.

Some predict that China will be exporting 10 per cent of its annual output by 1980, while others speculate on the order of 25 per cent. If the most optimistic production estimate of 400 million tons in 1980 should prove correct, the PRC might be able to export much more than 25 per cent of its oil output. We believe, however, that the 1980 production level is more likely to be closer to 200 million tons, and that internal demand will require all but approximately 50 million tons.

In the absence of any official basis of calculation, these figures may be more arbitrary than realistic, and one should not become mesmerized by a speculative numbers game. The important point is that there are reasonable grounds to expect China to greatly increase its oil export in the near future, for oil is becoming a vital factor in both Peking's foreign trade and its foreign policy.

Oil and Foreign Trade

Because China is bent on pursuing a policy of self-reliance, foreign trade has played a rather limited role in its economic development. But that role has been important, changing and gradually expanding. Gone are the days of the 1950s when China's trade was largely confined to the Communist world. Today trade with non-Commu-

cession area, had a substantial case, in U.S. eyes, and was making preparations for an offshore program of its own. Secretary Kissinger would take the matter up personally with Keck, they were cautioned, if the company persisted. In Taipei, a Clinton official asked the U.S. Embassy where it would be permissible to drill under Taiwan auspices. He was unable to get a direct reply but was told that it would *not* be advisable more than 200 miles from the island. Back in Houston, an anguished reappraisal had just begun when a threatening letter arrived from a Japanese oil firm (linked to Gulf) also claiming jurisdiction over Zones 4-E and 4-F.

Despite doubts aroused by the static from Washington and Tokyo, Superior was hesitant to renege on such a geologically attractive deal and was finally deterred from its drilling only by a last-minute complication indirectly linked with events in Vietnam. Since sophisticated, "semisubmersible" rigs cost some $50,000 a day to operate, and since it was so uncertain how China would react, Superior was prepared to drill only one well and had arranged to sublease the deep-water *Margie* from Shell. Shell had planned to use the rig extensively off Vietnam, but made an unannounced decision in early February to cut back on its Saigon commitments and canceled its contract for the *Margie*. At that point, in order to get the rig, Superior would have had to take over Shell's costly, long-term contract. The deal finally fell through amid a cloud of legal recriminations between Superior, Clinton, and bitter Taiwan government oil officials who blamed it all on Kissinger and talked of drilling on their own if necessary.

Danger in the Yellow Sea

In contrast to Superior, Gulf is accustomed to staring down the U.S. government and has kept its options open in the face of continuing State Department efforts to head off drilling in a sensitive area of the Yellow Sea. Gulf has two concessions

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off the west coast of South Korea, and the most promising geological structure in one of these lies relatively equidistant from the Korean and Chinese coasts in a potentially disputed zone just south of the 31st parallel.

China has not yet agreed to the median line principle in Law of the Sea discussions[6] and could well insist on geological criteria for sea boundaries more favorable to its interests. Moreover, in the case of the Yellow Sea, Peking does not recognize Seoul and is not likely to do so. Even if it did agree to a median line with South Korea, however, the projected Gulf drilling site near the 31st parallel would be on what the Chinese would be likely to claim as their side of the line. The Peking stand is readily deduced from Chinese maps indicating the islands that define Chinese coastal limits. But Gulf's lawyer, Northcutt Ely, argues that a case can be made against recognition of the islands in question under international law, and there are top Gulf officials who believe that the company should drill in any case, compelling Peking to make an issue of the matter if it chooses to do so.

"No oil company will withdraw from that part of the world until oil has been found and we've forced a resolve," one of these officials has explained. "Not until the claims have been resolved and we've been told by the governments concerned. Finding oil would act as a catalyst."

In a series of meetings with representatives of Gulf and its ex-partner in Korea, Zapata Exploration, between January and April, State Department officials urged Gulf not to drill in September, as planned, pressing instead for a new drilling location indisputably within the South Korean side of any future median line. Deputy Secretary of State Robert S. Ingersoll made a series of

[6] *The complex legal issues involved in the continental shelf controversy are discussed in the definitive works of Choon-ho Park of the Harvard East Asian Legal Studies Program. See especially "Oil Beneath Troubled Waters," Harvard International Law Journal, 1973. The author is indebted to Park for his help in dealing with these issues and related aspects of the China offshore controversy.*

output at an average annual rate of roughly 20 per cent, as we expect it will, and thereby produce something in excess of 200 million tons in that year.

Export Prospects

Yet, assuming the capability, will the PRC want to export 50 million or more tons of oil in 1980? China began to export oil in 1964 when, under a protocol on mutual supply of goods signed in Pyongyang the year before, an unspecified amount of oil was delivered to North Korea. In 1965, North Vietnam became the second country to receive Chinese oil. In neither case could the amount have been large, because China itself had barely become "basically" self-sufficient in 1963. Today, Chinese crude oil and oil products also go to Hong Kong, Japan, the Philippines, and Thailand. Other countries, including the United States, West Germany, Brazil, and Australia, are also looking forward to importing oil from China.

At present, Japan imports the most Chinese oil, having bought about four million tons for $410 million in 1974. In 1975, Japan is expected to import nearly eight million tons of oil from China. To a country which imports over 250 million tons of crude oil a year, this amount may symbolize little more than the growth of friendship. Of course, it is not the current amount of imported oil but the future potential that sustains Japan's interest in Chinese oil, which will be much less expensive to transport than Middle Eastern oil. Japan is also attracted by the low sulphur content in Chinese crude, ranging from 0.08 to 1 per cent. Its high wax content matters less to Japan than to other countries, such as the Philippines, which lack Japan's large refining capacity. Clearly, the Japanese will be happy to absorb much of the oil China may have available for export in the near future, and Japanese petroleum experts indicate that China may supply as much as 18 million tons in 1976.

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on the coastal shipping system. According to *The Economist*, China had only 130,000 passenger cars in 1970. Another source estimates the number of trucks to be approximately 650,000 at present. For a country China's size, the transportation network is still very sparse and the traffic density extremely light. But, according to an estimate of the Taiwan government, the amount of gasoline and kerosene consumed by motor vehicles and shipping craft accounts for over 45 per cent of refined oil products. This makes transportation the largest consumer of oil. National defense demand is estimated at slightly over 30 per cent.

"Oil is becoming a vital factor in both Peking's foreign trade and its foreign policy."

China's reliance on oil is plainly growing, not only absolutely but also in relation to other energy sources—especially its principal one, coal. The key question is the extent to which China's future energy needs are likely to absorb the expected substantial increases in crude oil production. If, as some observers assume, China's industrial output and coal production continue to grow at cumulative annual rates of 10 per cent and 7 per cent respectively, by 1980 primary energy demand would outstrip the coal supply by over 300 million metric tons of coal equivalents; petroleum products, natural gas, and hydroelectric power would be called upon to fill the gap; and 150 million tons of oil would barely cover two-thirds of it. Moreover, this projection is a simple extrapolation of the recent past and does not consider the great demand for oil that will soon be generated by the import of new industrial facilities.

Any such forecast is, of course, subject to a multitude of other variables. But it seems clear that if China is to have much of an oil surplus available for possible export in 1980, it will have to continue increasing

phone calls to Gulf Board Chairman Bob R. Dorsey, but Dorsey made no promises. Gulf has reportedly been under strong pressure from President Park Chong-hui to accelerate the search for oil in view of rising crude prices, and the pressure from Seoul was a matter of concern for Gulf in view of the company's many-sided stake there (e.g., $325 million in sales of Kuwait crude during 1974). Gulf's attitude abruptly changed in May, however, after Dorsey's revelation in Senate testimony that the company had been forced to pay $4.2 million in slush funds to Park's ruling Democratic Republican Party. Since then, Gulf has hinted that it will not drill this year, as part of a "low-profile" policy, though the door has been left open for the future fulfillment of its remaining drilling obligations to Seoul. Shell and Texaco, it might be noted, also have West Coast concessions but do not display a comparable desire to force a "resolve."

At the very least, renewed drilling in the Yellow Sea could provoke a Chinese political reaction that would aggravate the already delicate interplay between Peking, Pyongyang, and Washington. At worst, it could trigger a military incident. The danger of a Chinese military response to unwelcome drilling was underlined by the appearance of Komar-class gunboats less than a mile from a Gulf rig on three different occasions during the last drilling by the company off South Korea in February and March of 1973.

Peking and Pyongyang would both appear to have an interest in forestalling foreign drilling activities off South Korea. Pyongyang has consistently objected to the "country-selling" terms of South Korean offshore concessions and is anxious to frustrate oil discoveries that would help to make the Seoul regime viable. Peking, as a regional giant, would rather face Koreans than Americans in determining how the Yellow Sea is to be parceled out and how its development is to be organized. Already, Pyongyang is leaning heavily on Peking for its

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oil supplies, and China's bargaining power seems sure to grow in relation to the two Korean regimes as its offshore know-how increases.

China Goes Offshore

The Yellow Sea is a peculiarly inflammable arena of possible conflict over oil because Chinese offshore ambitions are currently centered there as a natural extension of the experimental activity hitherto undertaken in the Po Hai Gulf. It was at an undisclosed location in the "southern part" of the Yellow Sea that China's first domestically built offshore rig, *Kantan* (Prospector) *I*, drilled its much-heralded first test well last December in "fairly deep waters." Some of the most productive areas of the Takang and Shengli oil fields have proved to be in coastal marshlands along the Po Hai Gulf and the Yellow Sea coast, strongly suggesting the existence of offshore fields geologically linked to the onshore discoveries. The initial assignment of one of the new seismic survey boats recently acquired by Peking has been to see whether—and how far—the Takang and Shengli fields extend offshore.

Chinese interest in the potential of the Po Hai-Yellow Sea area as the natural starting point for offshore activity goes back to extensive oceanographic and marine geological studies of the continental shelf during the 1958-1961 period. While fascinated by the potential of the East China Sea, the oceanographer who directed these studies, Ch'in Yun-shan, emphasized the contrast between the shallow water of the Po Hai-Yellow Sea area, rarely exceeding 200 feet, and water three times deeper on the easternmost extremities of the East China Sea shelf.

Little is known concerning the extent of subsequent Chinese exploration activities during the 1960s, especially during the Cultural Revolution, but most evidence suggests that the Chinese fleet of some 35 oceanographic vessels has included at least three marine geological ships for at least a decade.

criticized. Moreover, despite PRC claims to the contrary, some foreign specialists believe that the growth of refining facilities has failed to match that of the oil fields. To the extent that this is true, the PRC will either have to curb extraction or export the surplus crude.

Domestic Demand

The volume of China's oil production will be importantly influenced by the anticipated domestic demand for oil as well as by external demand, the PRC's foreign trade needs, and its overall foreign policy goals.

Demand for oil in China has been very low. Because China has a basically agricultural economy, it has been possible to meet most energy requirements with coal, and China, along with the United States and the Soviet Union, is one of the three giant holders of coal reserves. According to a careful Japanese analysis, China meets over 85 per cent of its energy needs with coal, about 4 per cent with natural gas and hydroelectric power, and only slightly over 10 percent with oil. This is very different from the United States' 44 per cent and Japan's 73 per cent reliance on oil. Significantly, however, the 10 per cent figure represents an increased reliance on oil of two and one-half times during the past decade.

Agriculture, transportation, and defense are the three major oil consumers. The high agricultural demand reflects governmental efforts to modernize farming, based on the principle "Take Agriculture as the Foundation and Industry as the Leading Factor." This principle, in turn, rests on the rationale that agriculture "provides heavy industry with an important market."

The system of transportation in China consists of three principal components: roads, railroads, and inland waterways. Since 1949, roads are said to have been extended eight times to about 400,000 miles and railroads more than twice to about 25,000 miles. Water transport depends on internal navigable waterways of over 100,000 miles as well as

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one for coal industries and the other for petroleum and chemical industries. And the Ministry of Communications, which handled transport, reverted to two ministries, one for railroads and the second for other communications.

The transportation of oil presents special problems. With the exception of Shengli and Takang, major oil fields are situated far from industrial centers and often close to foreign borders. Yet railroad, barge, and truck capacities are already overburdened. Port facilities for coastal and outbound shipping are also known to be inadequate, as are cargo vessels and tankers. To make matters worse, oil, in both its crude and refined state, usually requires its own means of shipping. Progress has been made in building long-distance pipelines, but many obstacles are being encountered. For instance, Taching crude is known to have a relatively high solidifying point because of its higher wax content, so that the 1,152-kilometer pipeline to the port of Chin-huang-tao had to be provided with additional warming facilities in 19 places.

China has been making tremendous efforts to cope with the problem of mobility, so basic to modern industrial development, since its fourth five-year plan began in 1971. The measures taken include extensions of roads, pipelines, and railroads, improvement of port facilities, increased production of vehicles, and importation of transportation equipment. According to the National Council for U.S.-China Trade, the cost of transportation equipment imported between 1972 and the first half of 1974 totaled nearly $500 million, excluding air transport. Particularly noteworthy is the effort to improve port facilities. From mid-1972 until the end of 1973, China ordered 120 ships from Japan alone, of which more than 60 per cent were for dredging and improving ports.

Another possible limitation on oil production is China's refining capacity. The quality of refined products has often been

Given Chinese sophistication in seismological and computer sciences, Peking may have known more about its offshore oil potential for much longer than has generally been assumed in the West.

By 1972, Peking had slightly lifted the veil of secretiveness over its operations in Po Hai, where at least five and possibly as many as eight offshore rigs have been in use. Working at first from fixed platforms in the shallowest water, Chinese oil technicians had then contrived their own jerrybuilt, barge-style rigs, utilizing Rumanian and other imported components. The normalization of relations with Japan in 1972 opened the way for the acquisition of at least one foreign "jack-up" rig through Tokyo channels as well as several drillships and possibly a "semisubmersible" as well. Simultaneously, Peking was proceeding with its own domestic rig manufacturing program, using its new rigs, in effect, as working models. In addition to *Kantan I*, Peking has also announced a relatively advanced, self-escalating "jack-up," the *Po Hai I*, said to have a capability of drilling to 200 feet.

At this stage, China is not equipped to carry on extensive offshore test drilling beyond Po Hai and relatively close-in Yellow Sea areas. By next summer, however, Peking will have the first of two Singapore-made, U.S.-equipped, $33 million "jack-ups" capable of drilling in 275 feet of water. At least one other comparable rig has been ordered in Japan, and more are under active discussion not only in Japan but elsewhere. Supporting vessels and undersea pipe have been acquired or ordered from Denmark, Japan, and Italy. Most significant, China has been negotiating a $310 million order with a West German-French consortium for six "semisubmersible" rigs capable of drilling in the deepest and stormiest waters of the continental shelf concessions allotted by Taiwan.

In the rig trade, there are some cynics who accuse the Chinese of a canny variety of "window-shopping" that borders on pat-

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ent theft. Peking's "negotiations," it is alleged, are mainly a way of getting a feel for the latest foreign technology and of gathering ideas for use in Chinese rig-making. This suspicion is widespread, but is not shared by many of those who have dealt most intensively with the Peking agencies involved. The Chinese are afraid of being bilked, it is said, and are cautiously studying the ups and downs of the world rig market. Even if the "window-shopping" interpretation should prove valid, though, this would be of greater significance to rig companies than to U.S. policy-makers.

What matters in political terms is that China appears likely to have a substantially augmented fleet of rigs in the foreseeable future and will, accordingly, be able to conduct its own test drilling in contested areas where others have hitherto had a clear field. If Peking does buy rigs on the world market in quantity, this would speed things up; but in any case, rig purchases abroad would go hand in hand with accelerated domestic rig construction, based on foreign prototypes.

Peking's "self-reliance" approach is not meant to shut out foreign technology but rather to avoid technological dependence. This has been clearly foreshadowed by the way in which China has been upgrading its onshore oil capability with foreign help. By 1972, when Peking began to buy Western and Japanese equipment, China had a nucleus of trained personnel capable of incorporating foreign technology into a Chinese-controlled administrative infrastructure. More than $20 million of American equipment alone has subsequently been imported in order to maximize recovery from existing wells and to speed up the development of new oil fields.

So far, the Chinese have apparently been able to move into the more arcane areas of offshore survey work without letting foreign involvement get too far ahead of their own expertise. In a little-known but significant transaction, a leading French geophysical firm (Compagnie Général de Géo-

China will never try to exploit domestic or foreign natural resources in conjunction with other countries."

The second basic theme is planned exploitation to maximize the national heritage. This was aptly described in a Radio Peking report on the history of Taching oil field in January 1973: "As a Socialist country, China must protect the underground resources which belong to the people; it must not follow the predatory, imperialist ways of oil extraction which might produce quick results, but would do long-range damage to production." Such strictures have apparently failed to assure some segments of the populace, for Chinese media have recently taken pains to ridicule suggestions that natural resources can be exhausted and that their exploitation can be harmful. Peking claims that its methods of exploitation are selective, employing low-quality first extractive techniques in the interest of posterity.

Of course, the degree of China's success in oil production will reflect the types of problems encountered and the means chosen to meet them. Most problems appear to be common to other Chinese industrial sectors. The most serious is obviously a lag in the science and technology necessary for the development of oil, especially offshore. Until the energy crisis of 1973, China seemed content "to combine the native and foreign technologies." Since then, however, the PRC has placed considerable emphasis upon purchasing oil extraction and petrochemical facilities from the West and Japan, ordering over $1 billion of the latter alone.

Another challenge is to determine the optimum government organization for the efficient operation of oil-related industries. It is interesting to note that while the 49 component organs of the PRC executive branch, the State Council, were recently reduced to 29 in another of Peking's relentless efforts to streamline government, institutions concerned with energy were expanded. The Ministry of Fuels and Chemistry was reorganized into two full-fledged ministries,

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with surprise and skepticism, because each varied, by a wide margin, from plausible estimates that had been made by many observers.

A number of major factors will obviously influence the extent of China's oil production. To begin with, the PRC has a distinctive natural resources development policy, which operates within the framework of its overall principles of national development. Unlike some developing countries, China does not simply seek a higher rate of economic growth.

Vice Premier Teng Hsiao-ping reportedly remarked in October 1974 that "it will take 50 years to catch up with the West." Chou En-lai's report to the Fourth National People's Congress in January 1975 was somewhat more concrete. According to Chou, the order of priorities in China's national economic plan places agriculture first, light industry second, and heavy industry third. Chou outlined a two-stage development program covering a span of 35 years, the first stage being from 1966 to 1980 and the second from 1981 to the end of the century. The first stage aims at "an independent and relatively comprehensive industrial and economic system" and the second at "the comprehensive modernization of agriculture, industry, national defense, science, and technology." The basic five-year plans are to be drawn up with these objectives in mind.

In this context, two basic themes characterize China's natural resources development policy. The first is self-reliance. The exploitation of natural resources, especially oil, requires massive capital and technology, which can only be allocated at the expense of other priorities. Because of this, many developing countries that possess natural resources have invited foreign participation in their exploitation. Yet because of its insistence on keeping economic control in Chinese hands, the PRC has been extremely wary of foreign entanglements. As Foreign Trade Minister Li Chiang has put it, "Socialist

physique, or CGG) has sold Peking at least one late-model seismic survey ship, the *Lady Isabel*, a somewhat unconventional departure from the usual industry practice of furnishing services rather than know-how or equipment. The quid pro quo for the French appears to have been separate service contracts for ongoing survey work conducted in tandem with on-the-job training for Chinese technicians. Similar arrangements have also been concluded with CGG for one or more additional boats and with Sumitomo for several Japanese survey vessels, one of them just delivered.

Since it arrived in early 1974, the *Lady Isabel* has done initial seismic surveys in the Liaotung Bay (a corner of Po Hai), the Yellow Sea (between Tsingtao and Shanghai), and the South China Sea near Hainan. The seismic tapes from the boat are being interpreted in Peking with the help of CGG advisers, some of them Tokyo-based, and will eventually utilize a Raytheon 703 computer and related American equipment obtained in a $5.3 million deal with the Geospace Corporation of Houston. Twenty Chinese have been to Geospace headquarters for training, and 70,000 pounds of seismic processing equipment was recently airlifted to Peking in the first commercial jet cargo flight between the United States and China.

On their own, the Chinese have already gone far in computer technology and recently announced a "hybrid analogue" computer said to combine the advantages of the analogue and digital varieties. In operational terms, however, their computer processing center for seismic data in Peking is not yet equipped to cope with the enormous volume of data now coming in as a result of the explosion of offshore survey work. In addition to the Raytheon installation, meant mainly for onshore seismic data, Peking hopes to get additional processing equipment utilizing a Cyber 172, one of the largest U.S. computers. But like certain types of gravity meters, magnetometers, and other U.S.-licensed items sought by the Chinese as

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part of their CGG arrangements, the Cyber 172 has militarily applicable components and has yet to clear U.S. export control procedures. In general, the United States has adopted a policy of "not standing in the way" of the Chinese acquisition of oil-related technology. Some sales have been actively encouraged, partly for balance-of-payments reasons and partly in the belief that any increase in oil production anywhere will at least indirectly ease U.S. energy difficulties.

Playing for Time

As Western oilmen see it, the sensible thing for China to do would be to turn over its whole offshore exploration and development effort to a consortium of leading foreign companies who would work on a management contract basis and be paid in crude. This would expedite the process by years or even decades, it is argued, greatly multiplying the amount of oil available to China both for its political purposes and for financing its industrial imports. In this approach, the issues governing Chinese oil policy are posed from an "onshore" perspective, as it were, with a decision to "go offshore" seen as a function of economic variables alone. Thus, it is said, China will go offshore if it adopts an overall industrialization strategy calling for a growing volume of imports that necessitates, in turn, an ever-rising influx of foreign exchange. As the converse of this, it is argued that China will defer costly offshore risks indefinitely if it opts for a slower rate of modernization. An either-or choice is offered between one policy implicitly presupposing large-scale foreign involvement and another in which offshore activity is delayed as part of an inward-focused economic policy.

My own investigation suggests a middle ground between these extremes in which China moves systematically offshore for a combination of economic and political reasons. The pace of this process is likely to be governed not only by how much oil is desired but also by the rate at which China can

years, since 1960 China has effectively baffled foreign observers by virtually ceasing to publish economic statistics. Strictly speaking, therefore, the annual production figures cited above may possibly be considerably higher or lower than the actual ones, although they are based on careful conjecture.

With regard to future production, estimates made by different observers range from 130 to 400 million tons in 1980. The lower estimate presupposes an average annual oil production growth rate of 15 per cent during the fifth five-year plan (1976-1980), a figure that appears too pessimistic in light of China's achievements in recent years. The more optimistic estimate assumes a much higher growth rate than even recent achievements warrant and seems to originate partly from an ambition, attributed to informal Chinese sources, to produce half a ton of oil by 1980 for each of China's 800 million people. Our own expectation is based on the conservative assumption that, barring another political upheaval of the magnitude of the Cultural Revolution—an eventuality that cannot be dismissed, oil production will continue to increase at an average annual rate of roughly 20 per cent. This would probably make 1980 output somewhat in excess of 200 million tons. Plainly, this is too vague an approximation. Yet such speculation is inevitable in the absence of specific figures.

As long as China continues to withhold statistics, outside observers will fiddle with the percentages Peking releases, usually at the beginning of the year, leavening them with the sometimes casual remarks uttered by important leaders in meetings with foreigners. That the latter are a peculiarly difficult information source was well illustrated in two interviews granted by Premier Chou En-lai. Chou reportedly told Edgar Snow in 1971 that 1970 production had been about 20 million tons, and in 1973 he told Japanese Foreign Minister Ohira that the previous year's production had been approximately 50 million tons. These figures were received

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2.7 to 20 billion tons, with the upper limit growing steadily. Nonliquid reserves are thought to be much larger than liquid deposits and, at present, contribute over 10 per cent of the total output of crude oil in China. The oil content of the shale found in 14 shale-bearing regions is said to range from 4 to 27 per cent in terms of weight, with an average of 6 per cent. Estimates on oil-bearing coal and oil-sand are not known.

In 1959, the Deputy Minister of the Petroleum Industry, Li Jen-chun, was reported to have said that shale deposits in 21 provinces alone amounted to 360 billion tons and that, given an average oil content of 6 per cent, over 20 billion tons of crude oil might be extracted. But we should recall that statistics released during the "Great Leap Forward" of 1958-1960 were frequently exaggerated. Even so, nonliquid reserves seem to be large enough to supplement natural crude or even to substitute for it in case of its depletion. To be sure, extraction of oil from nonliquid sources will create additional problems, such as higher labor costs and pollution. Nevertheless, China is a labor-intensive society, and, in view of the PRC's political system, environmental issues do not pose the same challenge as they do for democratically elected governments.

Production

China's oil production, which was barely 10 million tons in 1965, may have exceeded 70 million tons in 1974. In terms of growth rate, oil led all major agricultural and industrial products during this period. Nevertheless, China's current output cannot be compared with that of the giant oil producers such as the United States, the Soviet Union, and Saudi Arabia, whose annual figures run as high as 400 to 450 million tons each, or even with that of other major producers such as Iran, Venezuela, Kuwait, Libya, Nigeria, and Canada. Moreover, in considering China's oil production figures, it is essential not to overlook the fact that, despite a modest improvement in recent

absorb foreign technology. So long as China can meet its domestic energy needs, it can afford to suffer delays in the expansion of its oil production for the sake of preserving its basic commitment to "self-reliance." At the same time, to the extent that offshore production can be increased under Chinese auspices, this would relieve pressure on onshore reserves and would be attractive in long-range economic terms. As a totalitarian state, one should bear in mind, China can engage in the speculative business of offshore drilling with less concern for an early payoff than foreign private operators.

On purely economic grounds, there might be a case for postponing offshore activity in order to concentrate available resources on the development of onshore oil, gas, coal, and hydroelectric power. Politically, however, offshore oil development offers a way to avoid concentrating too much oil activity near the Soviet border; and in any case, the continental shelf controversy would make delay difficult. Most of China's neighbors have unilaterally allocated concessions in areas where Peking has implicit or explicit claims and, sooner or later, China seems likely to respond to this affront in its own fashion. Military action would be one way of doing so where oil overlaps with other factors, as in the take-over of the Paracels last year, but would be at variance with the general tenor of current Chinese policy in Asia. Diplomatically, China seems reluctant to dignify its offshore disputes by agreeing to formal negotiations, especially since it regards two of the regimes concerned, Seoul and Taipei, as illegitimate and impermanent. Peking seems to be playing for time until its own offshore capabilities are more fully developed. In a few short years, China will be able to signal its intentions in specific areas with survey ships and rigs rather than gunboats. Just as its rivals are now seeking to stake their claim by doing seismic studies and drilling wildcat wells, so China will be newly equipped to do the same; and in such a war of nerves, others might well

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decide to back off in some of the key areas concerned. Already, in the Superior incident, the United States showed a degree of deference to incipient Chinese claims that have not even been formally spelled out yet.

Some observers have suggested that the development of the contested offshore areas will be delayed until sea boundary settlements can be reached. Perhaps it would be more meaningful to say that development will come when China is ready to participate in planning and executing the process on a basis of greater technological parity. This view is supported by the element of vagueness in the Chinese stand on Law of the Sea issues as they apply to Asia. By avoiding a precise definition of its attitude toward possible boundary settlements, Peking helps to paralyze offshore oil and gas production until it is prepared to play its hand.

Significantly, China makes a distinction between exploration and production. Chou En-lai has done so on the record, and the informal Chinese attitude is that Peking has nothing to lose by letting foreign exploration activities proceed up to the very brink of actual development. When Chinese offshore claims are asserted, it is said, Peking can then seek to obtain the data resulting from these exploration efforts by offering generous compensation to the foreign interests involved. This attitude could produce a deceptively mild Chinese approach to offshore controversies during the next several years. Given the apparent limitations of the seismic survey program it is developing, Peking appears unlikely to complete a preliminary assessment of its vast continental shelf before 1978. By that time, however, Peking may have acquired the first of its new foreign rigs and additional, domestically made rigs may also have been completed. The possibility of a more assertive Chinese stance would then be a real one, especially if there should be dramatic oil discoveries or embarrassing "blowouts" resulting in pollution. The offshore issue could

er belatedly. China seems to have made it a rule not to provide details about a new oil field until it has reached a "reportable" stage of development. It is, presumably, a result of this cautious practice that virtually nothing but their names is known of three other oil fields: Chiling ("seven-zero"), Chiuyisan ("nine-one-three"), and Wuchi ("five-seven").

The PRC's second decade was also marked by great progress in oil refining. Earlier this year, *Peking Review* claimed that the processing capacity of refineries constructed during the 1960s was eight times that in existence during the previous decade.

By the close of the 1960s, China's oil industry was ready to enter a new stage—not only continuing to increase production and refining capacity but also expanding into petrochemical fields.

Reserves

China's oil reserves are thought to be vast, including such nonliquid deposits as shale, oil-bearing coal, and oil-sand as well as offshore reserves. Yet the fact that new deposits are being found one after another and existing fields are being rapidly expanded suggests that China is still in the process of determining the amount of its reserves. With the exception of the Russian scientists who were in China during the 1950s, few foreign petroleum geologists have had access to Chinese soil since the founding of the PRC, while those who were there earlier simply stamped the country as poor in oil. Not surprisingly, foreign estimates of China's oil reserves, classified as confirmed, recoverable, and possible, range from 2.7 billion tons confirmed to 70 billion tons possible, including possible deposits offshore for which exploration is still in a preliminary stage. In these circumstances, it is basically impracticable, if not meaningless, to try to arrive at a precise estimate of what China itself seems to be still happily groping for.

Onshore crude oil reserves in China are estimated by different sources to range from

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which he was convinced China had in abundance. Li appears to have demonstrated that, at least in the case of China, oil can be present in inland basins and platforms of continental sedimentary deposits as distinct from marine sedimentary deposits, which generally comprise oil centers elsewhere. Li is sometimes called the father of oil exploration in China.

The most notable event in the history of oil development in China is the discovery, in 1959, of the famous Taching oil field in Heilungchiang province, northeast China. Without Taching, it would have been even more difficult than it was for China to survive the abrupt Soviet withdrawal of technicians and termination of cooperation contracts in July 1960, much less to achieve basic self-sufficiency in oil as early as 1963. Taching has understandably become China's jewel, although for a long time its location was kept from foreigners. The challenge which the oil workers had to overcome in order to find and extract oil in the appalling conditions of a vast wasteland and extremely harsh climate is now recalled with pride as a test of human perseverance.

The second decade of China's oil development was characterized by the discovery, in the mid-1960s, of two other major oil fields, Shengli and Takang, which have been built on the experience of Taching. Situated within 200 miles of each other near the shores of Pohai Bay, these two are known to compare very favorably with Taching in their current production and future prospects. Moreover, they have two decisive advantages over Taching. Their distance from the Sino-Soviet border is a strategic advantage. Their proximity to major Chinese industrial centers and to seaports is an economic advantage, especially because oil transportation is a substantial problem for China.

It is interesting to note that, like Taching, which means "great celebration," Shengli ("victory") and Takang ("great harbor") were not originally place names, and that their locations were also disclosed rath-

readily become entangled with unresolved power struggles in China and interlocked controversies over "self-reliance" and relations with the United States.

Taiwan and Oil Power

The linkage between offshore oil development and the future viability of a non-Communist Taiwan and South Korea makes these cases inherently more volatile than the narrower disputes over boundaries between China and its Communist neighbors, North Korea and North Vietnam, or between China and Japan. The future of Taiwan, in particular, would appear to be closely linked with the offshore issue. Peking would not necessarily oppose offshore development by Taiwan and its foreign collaborators in the context of a gradual movement of the island over time into the economic, diplomatic, and defense orbit of the mainland. By the same token, the use of offshore riches to move toward a sovereign Taiwan could trigger a hardening of the Chinese posture.

One significant factor affecting the Chinese attitude might be whether any oil and gas produced in offshore areas is tied directly into the welfare and development of Taiwan or is exported. Since China expects Taiwan to be mainland-controlled sooner or later, any contribution to its development is regarded, in principle, as desirable. By contrast, export earnings from oil could be viewed as a new source of foreign exchange for armaments and for other trappings of state power serving to strengthen the position of the Kuomintang regime.

Another key factor in Chinese eyes is likely to be where drilling occurs and what status for Taipei each location implies: an all-Chinese regime with jurisdiction over the mainland; a sovereign Taiwan coequal with Peking in international law; or provincial status within a Chinese framework. In the Superior incident, drilling was scheduled in an area that could only be claimed, juridically, by a government purporting to rule

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the mainland. The United States reacted unambiguously to this but has avoided further definition of the proper limits of Taiwan's offshore jurisdiction. Implicit approval of drilling within 200 miles would have major policy import, reflecting international law concepts applied to sovereign entities; as a province of China, Taiwan would have less extensive authority. To drill a well in the East China Sea 200 miles from the island would be a calculated political gambit in the Taipei-Peking chess game, just as a continued decision to stay within, say, 100 miles would imply acceptance of some form of provincial jurisdiction.

In the case of North Korea and North Vietnam, as I have indicated, China is utilizing its oil exports as a means of softening offshore boundary disputes. So far as is known, Pyongyang has been the more malleable of the two and has not yet made efforts to explore its own offshore areas comparable to the closely guarded arrangements commissioned by Hanoi. Peking and Hanoi have both conducted seismic surveys in the Tonkin Gulf and are not known to have a median line agreement there. More important, the China-Vietnam collision involves not only the median line issue in the Tonkin Gulf-Hainan area but also a basic territorial conflict in waters beyond the continental shelf over ownership of coral archipelagoes and island groups. Hanoi, unlike Saigon, has not made an overt issue of the Paracels, where Peking began onshore drilling soon after its take-over last year; but one of the Spratlys was reported occupied by the new Communist regime in Saigon soon after it won power. Nominal Chinese claims in the South China Sea reach almost as far south as the Philippines, Sabah, Brunei, and Sarawak, though it is not clear how seriously these are meant. In any case, with the shelf dropping off relatively close to shore, the South China Sea is generally much deeper than the East China Sea and much of it is likely to be beyond the reach of offshore drilling technology for some years.

PRC's production likely to be in the near future? To what extent will internal demand consume the oil produced? What factors can be expected to govern China's export prospects? What are the international, political implications of Peking's oil strategy?

The use of oil in China dates back to the first century B.C. Indeed, China was the first country to have an oil well, which was drilled in the early sixteenth century, preceding those of North America and Europe by more than 300 years. Nevertheless, oil development in its modern sense did not take place in China until the early 1950s, when the newly founded PRC launched an extraordinary drive in search of oil. Under the previous regime, the Republic of China (ROC), the country had produced a cumulative total of less than three million metric tons.

The emphasis which the PRC immediately placed on the oil industry may be seen from the fact that, in its first five-year plan (for 1953-1957), almost two-thirds of the entire national budget for the energy industry was earmarked for the development of oil resources. China's efforts to build its own oil industry benefited from the technical cooperation of the Soviet Union that it enjoyed until the end of the 1950s. Yet the achievements of the initial decade were more significant in terms of progress in geophysical surveys than in actual production. Without the groundwork laid during this period, the development of major oil fields during the next decade would not have been possible.

At this point, the contribution of an eminent Chinese geologist, Li Szu-kuang (1899-1971), deserves to be noted. He reportedly proved that Western petroleum geology was inapplicable to the geological structure of the Chinese continent and, through his own analysis, determined that China was not poor in oil. Interestingly, he is said to have withheld his findings during the previous regime because he feared what might otherwise happen to the oil resources

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THE POLITICS OF CHINA'S OIL WEAPON

by Choon-ho Park and Jerome Alan Cohen

Until recently, China was generally regarded as poor in petroleum and, in fact, had to rely on imports for most of its demand. One of the authors recalls asking former Secretary of State Dean Acheson in 1958 whether China could ever become a great power. Reflecting the accepted wisdom of the era, Acheson said that he was dubious about the prospect, because the country lacked the requisite mineral resources, especially oil.

Yet shortly afterward evidence to the contrary began to accumulate. In December 1963, the Second National People's Congress was told that "our country has now become basically self-sufficient in oil." Beginning in 1965, China's imports of crude and refined products began to decrease sharply, falling virtually to nil in 1968. In late 1968, a United Nations survey team reported that the continental shelf under the East China and Yellow Seas appeared to contain oil deposits perhaps as vast as those of the Persian Gulf, and optimistic estimates of China's onshore reserves also began to appear. In the meantime, China's production increased so rapidly that the People's Republic of China (PRC) began to export a modest amount of oil to a number of countries. Foreign offices, multinational corporations, and political pundits thus expect the oil-poor China of the past to emerge as an oil power of the future. Moreover, the energy crisis has provided a vivid reminder that the value of oil cannot be measured in economic terms alone, especially if it happens to be in the hands of a major political power. Hence the growing interest in what China is likely to do with its oil resources.

What accounts for China's sudden prominence as an oil producer? What do we know about its reserves? How large is the

On the surface, Japanese demands for recognition as a continental shelf power might appear to offer the most serious danger of offshore oil conflict in Asia. As part of its larger effort to offset Japanese-Soviet ties, however, China is soft-pedaling its claims to the disputed Senkaku islands and hopes to induce Japan to pigeonhole its own claims by stepping up oil exports. China does not occupy the Senkakus (as the Soviets do in the case of four disputed islands in the Kurile chain), and Japan can keep tabs on the situation, in any case, from the nearby Ryukyus. Tokyo appears ready to let the Senkakus hang in limbo, at least while the oil tap continues to flow from Peking.

Chinese oil exports to Japan are expected to reach eight million tons this year and 25 million tons by 1980 on the basis of already ongoing plans for port and pipeline improvements with Japanese assistance. This could quickly go much higher if China agrees to give Japan Takang oil rather than the presently supplied Taching variety, which competes directly with Indonesian imports already ordered on a long-term basis. On the whole, Chinese oil is prized in pollution-conscious Japan for its low sulphur content, though some grades are too waxy.

Peking has been teasing Japan with hints that it may get 10 per cent of future production on a regular basis, and there are competent Japanese analysts who see a chance for considerably more, as China's need for foreign exchange multiplies. The Japanese projection of 440 million tons by 1985, cited earlier, assumes an export volume in the neighborhood of 200 million tons. Japanese crude imports are now running about 300 million tons annually, and the maximum increases now anticipated would bring this near 600 million tons.

Conceivably, given a Taiwan settlement satisfactory to Peking, the U.S. West Coast might get token amounts of Chinese oil. An examination of this issue is beyond the scope of this article, but large-scale Chinese exports to the United States appear unlikely.

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In economic terms, this is easy to envisage; politically it would run counter to the underlying Chinese nationalist objective of building competitive power vis-à-vis the Western world.

At the very least, Japan sees an opportunity to obtain the lion's share of offshore oil and gas production in east Asia without incurring the attendant exploration risks. More optimistic Japanese leaders hope for a lucrative technical partnership role in the development of offshore resources not only in the Po Hai-Yellow Sea area but in the East China Sea as well. China has carefully left the door open for some form of Sino-Japanese understanding with respect to the continental shelf that would permit oil development to go forward even if title questions cannot be finally resolved.

Under one provision of the deliberately open-ended draft treaty issued by the Geneva Law of the Sea conference, China could agree to a median-line agreement with Japan, treating the East China Sea as a "semi-enclosed sea." Under another provision, China could claim control of the entire shelf up to the undersea "continental margin" just west of the Ryukyus (the provision in question permits title up to the margin in cases where the shelf is longer than the 200-mile economic zone envisaged in the draft treaty). Even under this latter provision, however, as China has intimated in informal Law of the Sea exchanges with Japan, there may be scope for negotiations on the division of the spoils beyond the 200-mile zone. What China seems to be suggesting is benign neglect of Japanese legal claims to the shelf and a face-saving neighborly agreement instead, couched in terms of mutual economic interest. The Senkakus would fall on the "Japanese" side of the 200-mile zone, but the title problem would be put aside indefinitely.

A Sino-Japanese agreement for some form of condominium in the East China Sea would unavoidably bring the Taiwan issue to a head. China's claims to the Senkakus

are in part an extension of its claims to Taiwan, and it is difficult to conceive of an oil-related Senkaku compromise that would not carry with it a Peking-Taipei agreement redefining the status of Taiwan as a province of China. So far, however, most Taiwan leaders discount the possibility of Sino-Japanese collaboration and predict, on the contrary, continuing tension between Peking and Tokyo. In this view, Peking is not bothered by Taiwan's claims in the East China Sea and would rather see drilling there under the auspices of anti-Communist Chinese than inroads by Japanese of any persuasion. Tokyo has allocated "shadow" concessions that overlap the Taiwan claims (one of those in the Senkaku area is backed by Nippon Steel) but hitherto has withheld authorization for drilling.

What is the prospect for Sino-Japanese relations? How far is Tokyo prepared to go in offsetting its Middle East dependence with a new dependence on Peking? A long and complex bargaining process lies ahead, and the outcome is far from clear. The intensity of recent Chinese efforts to push Japan into an overtly anti-Soviet stance has induced a new note of caution in the Japanese attitude. At the same time, Japanese distrust of the Soviet Union has deep historical roots and stands in striking contrast to the positive cultural chemistry pervading the Sino-Japanese relationship.[7] Many of the same conservative leaders who were most opposed to the 1972 normalization are now the most fervent advocates of cooperation with Peking, their anti-Communism dissolved not only by the findings of petroleum geology but by a resurgence of pan-Asian pride. Even before Takang and Po Hai, it should be remembered, there were powerful psychological factors drawing Tokyo toward Peking. It is in this context that China's oil potential should be most carefully measured in the decades ahead.

[7] *The author discusses this in "China and Japan: The New Partnership," The Washington Post, March 4, 1973, p. B 5, and in a forthcoming book.*

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